

At a time when banks want to serve each customer as fully as possible, most don't yet have a good grasp on priority household financial needs and the value of meeting them.

The Case for Building Customer Lifetime Value

BY SHERIEF MELEIS

At a time of revenue drought in retail banking, there is tremendous pressure to ramp up sales within the individual product units. Yet many banks are sacrificing significant opportunity by failing to look beyond products to the total customer relationship.

It seems odd in an age of information, but most banks don't yet have a good grasp of the composite needs of individuals and households. This analytical gap is a hangover from former strong economic cycles, when surging customer demand helped to satisfy the essential quest for sales volume.

Now, however, there is a pressing need to serve each customer as fully and proactively as possible. Instead of freeing the product groups to focus strictly on their own current-year profits, progressive banks are learning to base marketing decisions on the more comprehensive measure of customer lifetime value (CLV).

Along with more carefully considering the full range of customer needs, CLV provides a more robust frame of reference to manage and measure progress. Specifically, CLV considers how various individual products mesh with each other to encourage cross-sell and build long-term relationship profitability. It also explicitly recognizes the "hidden value" in deep customer relationships, including the potential for reduced credit risk; longer account tenure and higher product usage; and improved pricing power.

As an example of CLV in action, consider the current banking challenge with the demand deposit account. Given the successive crackdowns on overdraft and debit fees, there is a tendency to back away from checking. But this short-term view overlooks the fact that checking's potential CLV is still quite attractive – \$3,000 to \$4,000 – provided the bank can follow through with effective cross-sell of the right downstream products.

Most immediately, an action plan based on customer lifetime value includes: 1) quantifying the "hidden value" in deep customer relationships; 2) identifying the customer behaviors and product combinations that really matter (from a total CLV perspective); and 3)

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setting priority marketing initiatives, based on knowledge of the total customer relationship. Longer term, CLV can be incorporated into a variety of customer-facing activities and decisions in the organization.

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CROSS-SELL PRIORITIES

To set a solid foundation for cross-sell, activities must be identified and prioritized within the context of customer needs and receptivity, along with variations in economic potential. The “best first product,” for example, long has been viewed as the checking account. But there are other valuable points of entry to a profitable customer relationship, include the credit card and the money market deposit account.

As leading banks work through these questions, they are using the findings for a number

of important applications. One immediate priority is targeted marketing: matching the right offers with right customers. Another is relationship packaging and pricing: incenting customers to acquire multiple products at the points of sale. Other applications include credit decisioning (taking fuller advantage of household information in loan origination and risk management); organizational incentive design; and managing the branch and call center sales process.

The urgency of such initiatives is heightened by the fragmented state of customer relationships in retail banking, where a single provider typically serves no more than 20% of a household’s financial needs. A side effect is extreme duplication of expensive branch networks. In the current tight market, winning banks will avoid slash-and-burn cost cuts by focusing on profitable relationship expansion, as guided by customer lifetime value and the larger frame of reference it permits. Others will lose market share, creating more pressure for deep capacity cuts that could lead to even more problems down the road.

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